HIGHLANDS MALAYA PLANTATIONS LTD.

v.

DIRECTOR-GENERAL OF INLAND REVENUE

HIGH COURT MALAYA, KUALA LUMPUR
HARUN HASHIM J
[TAX APPEAL NO. A2/83]
31 DECEMBER 1986

REVENUE LAW: *Income Tax - Appeal against additional assessment of income tax - Group Bonus Scheme for managerial staff of appellant - Whether this additional remuneration a commission or a bonus payment - Income Tax Act 1967 - Section 33 - Section 39(1)(h) - Issue - Whether said Scheme is a bonus or not within the meaning of s. 39(1)(h).*

The appellant appealed against the Deciding Order of the Special Commissioners of Income Tax in confirming the additional assessment of income tax amounting to RM319,066.50 for the year of assessment 1975 raised by the respondent in 1980 on the appellant. Amongst the employees of the appellant, there were two categories of staff, namely

(a) The managerial staff who, in addition to a monthly salary, were entitled to participate in the Group Bonus Scheme; and

(b) The clerical staff who, in addition to a monthly salary, were paid an annual bonus at the discretion of the appellant.

The Group Bonus Scheme, introduced in 1961, was based on a number of factors, namely: status of employees (based on responsibilities); amount of salary drawn; duration of service and planted acreage managed; for which points were given for equitable distribution of a provision created by reserving 4% of the agricultural profits of the Group; the amount of payment varied with the number of points earned by each participant.

The annual bonus paid to the clerical staff was at the discretion of the appellant. For the last 12 years the clerical staff received discretionary bonus payments annually in excess of two month's salary.

In 1975, the Income Tax Act 1967 ("the Act") was amended by the addition of para. (h) to s. 39(1). In 1976, this additional provision was amended to the effect that in ascertaining the adjusted income of any person from any source, no deduction from the gross income from that source for that period shall be allowed in respect of any sum paid up by way of bonus to an employee in excess of RM1,000 or 2/12ths of his wages or salary whichever is the greater.

The appellant does not dispute its liability to tax in respect of the bonus payments to its clerical staff but disputes the applicability of s. 39(1)(h) of the Act to the Group Bonus Scheme of the managerial staff.

The question before the Special Commissioners was whether the additional remuneration paid to the managerial staff of the appellant under the Scheme was a **commission** and therefore deductible as an expense wholly and exclusively incurred in the production of gross income of the appellant within the meaning of s. 33 of the Act or whether it was a **bonus payment** within the meaning of s. 39(1)(h) of the Act and therefore disallowed as a deductible expense beyond the limits stipulated therein.

The Special Commissioners decided that the additional remuneration was a bonus payment within the meaning of s. 39(1)(h). Hence this appeal.

Held:

[1] It is true that bonus is usually paid when a company makes a profit but it does not follow that bonus will be paid to employees each year the company makes a profit when there is no contractual obligation to pay as in the case of the clerical staff. On the other hand, there is a contractual obligation to pay out 4% of the agricultural profits of the group to the managerial staff. The fact of sharing a percentage of the profits truly deserves the label of "commission" rather than a "bonus". The real distinction between a commission and a bonus is that a commission is contractual whereas a bonus is gratuitous.

[2] The real character of the Group Bonus Scheme is an incentive payment scheme geared to performance and productivity and properly falls as an expense wholly and exclusively incurred in the production of the gross income of the appellant within the meaning of s. 33 of the Act.

[3] Indeed the correct approach to the question before the Special Commissioners is not whether the Scheme is a commission or some other form of payment but rather whether it is a bonus or not within the meaning of s. 39(1)(h).

[4] The word "bonus" appearing in s. 39(1)(h) should be given its ordinary meaning and should not be stretched to include payments which are contractual and not gratuitous. Accordingly the Revenue and the Special Commissioners were in error in deciding that the Group Bonus Scheme of the appellant is a bonus payment within the meaning of s. 39(1)(h) of the Act.

[Appeal allowed with costs. Additional assessment of income tax for Y/A 1975 discharged.]

Case referred to:
Commissioners of Inland Revenue v. Weslegan and General Assurance Society 30 TC 11

Legislation referred to:
Income Tax Act 1967, ss. 13(1)(a), 33, 39(1)(h)

Other sources referred to:
Australia Income Tax Law & Practice, Mannix
Shorter Oxford Dictionary

For the appellant - S. Woodhull; M/s. Shearn Delamore & Co.
For the respondent - Zulkifli bin Ahmad Makinuddin, Senior Federal Counsel

JUDGMENT

Harun J:

This is an appeal from the Special Commissioners of Income Tax against their Deciding Order in confirming the additional assessment of income tax amounting to RM319,066.50 for the year of assessment 1975 raised by the respondent in 1980 on the appellant.

The appellant company was a subsidiary of a company registered in the United Kingdom and was one of a group of 11 companies (the Group) wholly owned by the principal company. The appellant and all members of the Group were managed by Barlow Estates Agency Sdn. Bhd. (the Agent). All staff employed in the Group were engaged through standard letters of appointment. The staff so appointed were transferable or interchangeable within the Group. All the companies in the Group are in the plantation industry.

Amongst its employees, there were two categories of staff, *viz.*

(a) The managerial staff who, in addition to a monthly salary, were entitled to participate in the Group Bonus Scheme; and

(b) The clerical staff who, in addition to a monthly salary, were paid an annual bonus at the discretion of the appellant.

The Group Bonus Scheme was introduced in 1961. The scheme was based on a number of factors, viz. status of employees (based on responsibilities); amount of salary drawn; duration of service and planted acreage managed; for which points were given for equitable distribution of a provision created by reserving 4% of the agricultural profits of the Group; the amount of the payment varied with the number of points earned by each participant. The appellant reserved the right to:

(a) Withhold or reduce the amount due to any employee on an adverse report or on the person concerned terminating employment with the appellant; and

(b) Adjust the points in respect of any special qualification of any individual employee, e.g., service in the industry or other special qualifications.

Entitlement to participate in the scheme is one of the terms of employment contained in the standard letter of appointment issued to all managerial staff and therefore contractual.

The appellant has been making payments under the scheme every year since 1961 and the amount for distribution varied from financial year to financial year depending on the agricultural profits of the Group.

The annual bonus paid to the clerical staff was at the discretion of the appellant, that is to say, there is no term in their contract of employment with the appellant that they are entitled to the payment of the bonus. For the last 12 years, however, the clerical staff received discretionary bonus payments annually in excess of two months' salary.

In 1975, the Income Tax Act 1967 (the Act) was amended by the addition of para. (h) to s. 39(1) which reads:

> Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment no deduction from the gross income from that source for that period shall be allowed in respect of:
>
> (h) any sum paid by way of a bonus to an employee in excess of two-twelfths of his wage or salary.

In 1976, this additional provision was amended to read as follows:

> (h) any sum paid by way of bonus to an employee in excess of one thousand ringgit or two-twelfths of his wages or salary whichever is the greater.

The appellant does not dispute its liability to tax in respect of the bonus payments to its clerical staff in excess of two months' salary but disputes the applicability of s. 39(1)(h) to the Group Bonus Scheme of the managerial staff.

The question before the Special Commissioners was:

> Whether the additional remuneration paid to the administrative staff (i.e., the managerial staff) of the appellant under the scheme is a **commission** and therefore deductible as an expense wholly and exclusively incurred in the production of gross income of the appellant within the

meaning of s. 33 of the Income Tax Act 1967; or is a **bonus payment** within the meaning of s. 39(1)(h) of the Act and therefore be disallowed as a deductible expense beyond the limits stipulated therein.

The Special Commissioners decided that the additional remuneration is a **bonus payment** within the meaning of s. 39(1)(h). Hence this appeal.

The words "bonus" and "commission" are not defined in the Act. The general rule is that words in a statute should be given their ordinary meaning. The *Shorter Oxford Dictionary* defines:

Bonus - A boon or gift over and above what is normally due. A premium for services rendered or expected.

Commission - A *pro rata* remuneration for work done as agent 1725.

The Special Commissioners held that as commissions are only paid to agents and the managerial staff of the appellant are employees, therefore these payments must be bonus, whether contractual or otherwise. Other reasons given for their finding are: the fact that the word "bonus" is used for the scheme and the appellant made no effort to change it; the fact that the Special Commissioners made similar decisions in three other cases and there has been no appeal against such decisions.

Section 13 of the Act contains general provisions as to **employment income** and subsection (1)(a) reads:

(1) Gross income of an employee in respect of gains or profits from an employment includes:

(a) any wages, salary, remuneration, leave pay, fee, commission, bonus, gratuity, perquisite or allowance (whether in money or otherwise) in respect of having or exercising the employment;

The Act clearly provides that commissions are payable to employees and not restricted to agents when it was first used in 1725. That the word commission does not have such a restricted meaning is well illustrated in Mannix: *Australia Income Tax Law & Practice* where reference is made to the word "commission". There, as here, the definition of income from personal exertion includes "commissions". There too, the word commission is not defined in the law. Mannix quotes a passage from a judgment which reads:

In its relevant sense the word "commission" has no technical meaning. The relevant sense of the word is, of course, its commercial sense, but we are satisfied that it has no precise meaning even in commerce. It is, of course, applied - and no doubt most frequently - to the ordinary remuneration of an agent in the form of a percentage on the value of business done. It is sometimes applied to remuneration received in that form by an employee. It is obvious, however, that the word is not confined in commerce to the remuneration of agents or employees, whether in the form of a percentage or otherwise ... It appears that commission may be earned merely by doing something which results in contracting parties being brought together: see ***Wharton's Law Lexicon*** - citing *Green v. Bartlett* [1863] 32 LJCP 261. We have formed the opinion that the word "commission" is appropriate to describe any payment received as a reward for doing some act, or imparting some information in consequence of which the payer either does business or is enabled to do it.

In *Commissioners of Inland Revenue v. Weslegan and General Assurance Society* 30 TC 11 Viscount Simon in the House of Lords said at p. 25:

> It may be well to repeat two propositions which are well established in the application of the law relating to Income Tax. First, the name given to a transaction by parties concerned does not necessarily decide the nature of the transaction. To call a payment a loan if it is really an annuity does not assist the taxpayer, any more than to call an item a capital payment would prevent it from being regarded as an income payment if that is its true nature. The question always is what is the real character of the payment, not what the parties call it.

What then is the real character of the payments under the Group Bonus Scheme. Here the Special Commissioners found as a fact that the scheme is based on profits and the individual efforts put in by the managerial staff. It also found that the payments are contractual but went on to hold (at p. 24) that the scheme "merely provides a criteria by which the "bonus" is paid ... Therefore it is logical that payment of bonus is tied to performance and profitability. On the other hand, the argument that this sort of payment be termed as "commission" should not be upheld. Our view is based on the facts proved or admitted at the hearing and the general principles of law applicable therein."

In my view therein lies the fallacy of the thinking of the Revenue and the Special Commissioners. It is true that bonus is usually paid when a company makes a profit but it does not follow that bonus will be paid to employees each year the company makes a profit when there is no contractual obligation to pay as in the case of the clerical staff. On the other hand, there is a contractual obligation to pay out 4% of the agricultural profits of the Group to the managerial staff. The fact of sharing a percentage of the profits truly deserves the label of "commission" rather than a "bonus". It seems to me that the real distinction between a commission and a bonus is that a commission is contractual whereas a bonus in gratuitous. It is a contradiction in terms to speak of a **contractual bonus** because bonus by definition is gratuitous and there cannot be a contract to do something which is not expected.

The trouble is that the word "bonus" has been used too freely in contracts of employment in this country to denote a lump sum payment made each year in addition to wages or salary whether contractual or not. If the lump sum payable is a fixed sum or an amount certain and contractual it is in fact **deferred salary**, e.g., the 13th month salary, and should not be called a bonus. If the payment is not contractual then it is truly a **bonus**. If the payment is contractual, based on individual effort and in the form of a percentage as an incentive to productivity it is more appropriate to describe the payment as a **commission**. This system of incentive payments is familiar in the plantation industry and has been practised for many years e.g. amongst rubber tapper who, in addition to the fixed daily wage are paid an "incentive bonus" for bringing in latex in excess of a fixed daily poundage. In introducing the scheme on 21 September 1960, the Agent said:

> It gives due reward to the senior and experienced men for their extra responsibility and knowledge and at the same time provides the new assistant with the incentive to prove himself a valuable member of the staff.

The real character of the Group Bonus Scheme is therefore an incentive payment scheme geared to performance and productivity and properly falls as an expense wholly and exclusively incurred in the production of gross income of the appellant within the meaning of s. 33 of the Act. Indeed the correct approach to the question before the Special Commissioners is not whether the scheme is a commission or some other form of payment but rather whether it is a bonus or not within the meaning of s. 39(1)(h).

The word bonus given its ordinary is a gratuitous payment. The intention of the legislative in amending the law is to limit *ex-gratia* payments called bonus to a maximum equivalent of two months' salary by penalising the employer who pays in excess of the maximum in order

to discourage the practice of enhanced bonuses against lower wages. I think it is fair to say that it is not the intention of the legislature to discourage employers from providing incentives to increase productivity and profits. I hold that the word "bonus" appearing in s. 39(1)(h) should be given its ordinary meaning and should not be stretched to include payments which are contractual and not gratuitous.

I accordingly find that the Revenue and the Special Commissioners were in error in deciding that the Group Bonus Scheme of the appellant is a bonus payment within the meaning of s. 39(1)(h) of the Act. I would therefore allow the appeal and discharge the additional assessment of income tax for the year of assessment 1975 with costs here and below.

Also found at [1987] 1 CLJ 187